

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
SAN ANGELO DIVISION

In Re:	§	
	§	
JOHN C. BAUM AND	§	CASE NO. 03-60408-RLJ-7
LINDA D. BAUM,	§	
	§	
Debtors	§	
<hr/>		
JOHN C. BAUM AND LINDA D. BAUM,	§	
	§	
Plaintiffs	§	
	§	
VS.	§	ADVERSARY NO. 04-6001
	§	
FIRST COLEMAN NATIONAL BANK,	§	
	§	
Defendant	§	

MEMORANDUM OPINION

By this adversary proceeding, the plaintiffs, John and Linda Baum, contend that First Coleman National Bank had an invalid deed of trust lien, and thus held an invalid and void foreclosure sale against the Baums' claimed rural homestead. The Baums argue that the Bank's lien violated the Texas Constitution. By their pleadings, the Baums also asserted a claim under the Federal Truth in Lending Act. The Bank denies these claims.

Findings of Fact

1. The debtors, John and Linda Baum (the "Baums"), are married and have three children. At the time of the filing of this bankruptcy case, November 4, 2003, John Baum was a contractor in the highway repair business. He maintained a corporation, Baum Construction Company, Inc., under which he conducted the business.

2. In July 1998, the Baums moved to Coleman County where they had purchased thirty acres at a location named "White Chapel." They resided there for three years.

3. On July 12, 1999, the Baums purchased a 392.75 acre tract from Robert W. Allen and his wife, M. S. Allen (the "Allens"), which conveyance was by Warranty Deed with Vendor's Lien recorded in volume 690, beginning on page 167, in the deed records of Coleman County, Texas. The 392.75 acre tract will be referred to as the "Ranch." The Baums purchased the Ranch with the intention at some point in the future of building a home there.

4. On May 8, 2000, the Baums signed a Designation of Homestead and Affidavit of Non-Homestead, which identified the White Chapel property consisting of 30 acres and 169.65 acres of the Ranch as their homestead. The instrument recites that a 2.32 acre tract out of Lot No. 9 of the Lost Creek Acres, Coleman County, Texas, was not their homestead. This designation is recorded in the Coleman County real estate records.

5. In 2001, the Baums sold the White Chapel residence and purchased a home described as located at 2705 Guadalupe. The Guadalupe property consists of 2.292 acres. The Guadalupe home lies outside the Coleman city limits, and receives electric service from Coleman County Coop, which services rural properties; it has a propane tank for gas; a septic system for sewer; and water is provided by the City of Coleman.

6. On or about February 4, 2002, John Baum signed an Application for Residential Homestead Exemption regarding 2705 Guadalupe and submitted same to the Coleman County Tax Appraisal District for the year 2002.

7. The Baums commenced construction of a residence at the Ranch in March 2002.

8. On or about June 12, 2002, the Baums executed and entered into that certain Building Contract dated June 12, 2002, by and between John C. Baum and wife, Linda D. Baum, as owners, and Signature Building, as contractor, which was filed for record on June 24, 2002, and recorded on June 25, 2002, in volume 28, at page 708, of the mechanic's lien records of Coleman County, Texas. *See* Def.'s Ex. 9.

9. Prior to August 30, 2002, the Baums maintained cattle and horses on the Ranch and engaged in various activities at the Ranch. They hunted, fished, rode horses, swam, and held Cub Scout activities at the Ranch.

10. On August 30, 2002, the Baums entered into a loan transaction with First Coleman National Bank (the "Bank") pursuant to which the Bank agreed to lend and the Baums agreed to borrow up to \$750,000 to be secured by a first lien deed of trust on the Ranch in Coleman County, Texas (the "Loan").

11. The loan closed on August 30, 2002.

12. On August 30, 2002, the Baums, as makers, executed and delivered a promissory note payable to the order of the Bank that evidenced the Loan. *See* Def.'s Ex. 2.

13. On August 30, 2002, the Baums, as grantors, executed and delivered a deed of trust dated August 30, 2002, which was intended to grant a first priority deed of trust lien against the Ranch and which was filed for record in the deed of trust records of Coleman County, Texas, on August 30, 2002, and recorded by the County Clerk of Coleman County, Texas, on September 3, 2002. *See* Def.'s Ex. 3.

14. On August 30, 2002, for the purpose of obtaining the loan, the Baums signed, swore

before a notary public, and delivered the Designation of Homestead and Affidavit of Non-Homestead dated August 30, 2002. *See* Def.'s Ex. 4. By this instrument, the Baums designated 2705 Guadalupe (2.292 acres) as their homestead and declared that the Ranch was not their homestead. *Id.*

15. On August 30, 2002, when they signed and swore to the Designation of Homestead and Affidavit of Non-Homestead, the Baums each knew that the Bank was relying on the Designation of Homestead and Affidavit of Non-Homestead in the making the Loan.

16. Closing costs in the amount of \$5,889 were incurred in connection with the making of the Loan. *See* Def.'s Ex. 1.

17. At the request of the Baums, the sum of \$172,141.66 from the proceeds of the Loan were disbursed at closing by Coleman County Title Company to pay off the existing purchase money indebtedness in the amount of \$172,141.66 owed by the Baums with respect to their original purchase of the Ranch in 1999, which purchase money indebtedness was secured by an existing vendor's lien and deed of trust lien held against the Ranch by the Allens.

18. The Allens endorsed and delivered the Real Estate Lien Note executed by the Baums to the Bank. *See* Def.'s Ex. 5.

19. The Allens executed and delivered to the Bank a Transfer of Lien dated August 30, 2002, which was filed for record on September 23, 2002, in the office of the County Clerk of Coleman County, Texas, and recorded on September 24, 2002, in volume 712, pages 880-882, in the office of the County Clerk of Coleman County, Texas. *See* Def.'s Ex. 8.

20. Signature Building executed and delivered to the Bank that certain Transfer of Building Contract Note and Lien dated August 30, 2002, executed by Signature Building, and filed for record on October 1, 2002, and recorded on October 2, 2002, in volume 713, at pages 116-118, of the deed records of Coleman County, Texas. *See* Def.'s Ex. 10.

21. On August 30, 2002, an Abstract of Judgment in favor of Robert Knowles Auto Center for a judgment rendered against John Baum was of record in the Coleman County Clerk's Office, having been previously filed for record and recorded on August 12, 2002. *See* Def.'s Ex. 11.

22. From the proceeds of the Loan, the sum of \$5,039.32 was disbursed by the Bank to pay off the Judgment held by Robert Knowles Auto Center.

23. In consideration of payment, Robert Knowles Auto Center executed and delivered a Release of Judgment Lien which was filed for record on September 3, 2002, and recorded on September 4, 2002, in volume 712, at page 560, deed records of Coleman County, Texas. *See* Def.'s Ex. 12.

24. While there is some dispute regarding the use of the loan proceeds from the Loan for the construction of the residence at the Ranch, the Court finds that approximately \$259,000 was advanced to pay for such construction. As stated (Finding 17), \$172,141.66 was used to pay the purchase money lien held by Robert W. Allen and M. S. Allen. Of the balance, over \$307,000 was used in John Baum's business. *See* Def.'s Ex. 39.

25. The Baums' relationship with the Bank extended back to 1999. Over the course of the following three years, the Baums had, according to Tommy Sloan, the Bank president, as many as

thirty to fifty loans with the Bank. Most of these loans were short-term and were extended for working capital or equipment purchases.

26. The Loan was made to effect a restructuring of the Baums' debt at the Bank and to provide financing for the construction of the Baums' residence at the Ranch. The Baums had experienced cash flow problems and the Bank was concerned that its loans were at risk. In April 2002, the Bank was specifically concerned about a receivable from the Texas Department of Transportation that had not been paid over to the Bank. *See* Def.'s Ex. 19.

27. The Loan shored up the Bank's collateral position and converted short-term debt into long-term debt. The note evidencing the Loan provided for a twenty-five year amortization. At least to the extent the Loan refinanced the Baums' business debt, it lowered the payments and improved cash flow. Given that a significant portion of the Loan proceeds were used to finance the construction of the Baums' residence at the Ranch, the Court cannot conclude that the Baums were better off financially as a result of the Loan.

28. On August 30, 2002, the Baums owned the property at 2705 Guadalupe, Coleman, Texas.

29. On August 30, 2002, the property at 2705 Guadalupe was under contract of sale from at least July of 2002.

30. The Baums sold the property at 2705 Guadalupe to David Justiss and his wife, Annette Justiss, which sale closed on September 4, 2002. The closing had been delayed by several weeks.

31. By letter dated November 23, 2003, the Baums requested rescission of the August 30, 2002, loan with the Bank. *See* Def.'s Ex. 60.

32. By letter dated December 15, 2003, a Notice of Acceleration and enclosed copy of Notice of Trustee's Sale was sent on behalf of the Bank and received by the Baums. *See* Def.'s Ex. 61.

33. The Notice of Trustee's Sale dated December 15, 2003, was posted at the Coleman County Courthouse on December 15, 2003. *See* Def.'s Ex. 62.

34. The Bank foreclosed the Ranch on January 6, 2004. The Trustee's Deed concerning the Ranch dated January 6, 2004, was executed by Tommy Sloan, as Trustee, to the Bank.

35. From at least early January 2002, John Baum resided, at least part time, on the Ranch. He had run for County Commissioner and, to qualify as a candidate, used the Ranch address as his place of residence. Prior to building a residence at the Ranch, Baum lived in the living quarters that were located in the barn that was located at the Ranch.

36. If appropriate, these findings of fact shall be considered conclusions of law.

Conclusions of Law

Baums' Homestead Claim

37. This court has jurisdiction of this matter under 28 U.S.C. § 1334(b). This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2).

38. The court first addresses whether 2705 Guadalupe or the Ranch, or both together, constituted the Baums' homestead at the time the loan was closed on August 30, 2002.

39. It is undisputed that on August 30, 2002, Mrs. Baum and the Baums' children resided at 2705 Guadalupe. The evidence at trial reveals that 2705 Guadalupe property qualifies as a rural homestead. *See* Finding of Fact 5.

40. Considered separately, the Ranch did not, standing alone, qualify as a rural homestead on August 30, 2002, because the Baum family did not reside there. For example, if 2705 Guadalupe were an urban homestead, the Ranch would not constitute a separate rural homestead.

41. As 2705 Guadalupe constituted a rural homestead, the Court considers whether the Ranch, or a portion thereof, may be part of a full 200 acre rural homestead. If the party claiming rural homestead protection resides on a separate tract of land, the uninhabited property must be used in connection with the home tract for the comfort, convenience, or support of the family. *In re Webb*, 263 B.R. 791-92 (Bankr. W.D. Tex. 2001); *Cocke v. Conquest*, 120 Tex. 43, 52, 35 S.W.2d 673, 678 (1931); *Brooks v. Chatham*, 57 Tex. 31, 1882 W.L. 9451*2 (Tex. 1882).

42. At various times, the Baums maintained cattle and horses at the Ranch. As noted, they hunted, fished, rode horses, swam, and carried on various family activities at the Ranch. In addition, Mr. Baum apparently spent nights at the Ranch. In the spring of 2002, the Baums had begun construction of their residence on the Ranch. *See Gregory v. Sunbelt Sav., F.S.B.*, 835 S.W.2d 155, 158 (Tex. App.--Dallas 1992, reh'g denied) ("The homestead character of property can be established prior to actual occupancy when the owner intends to improve and occupy the premises as a homestead." The Court is satisfied that the Baums' use of the Ranch prior to and as of August 30, 2002, was sufficient to qualify the Ranch (or a portion thereof), as part of a rural homestead.

Estoppel

43. The next issue is whether the Baums are estopped from claiming the Ranch as a homestead in light of their disclaimer of the Ranch as homestead.

44. Misrepresentations by debtors, such as a disclaimer of homestead, may give rise to an

estoppel claim and bar the debtor's claim of homestead. *First Interstate Bank of Bedford v. Bland*, 810 S.W.2d 277, 283 (Tex. App.--Fort Worth 1991). Thus, "[a] disclaimer of the homestead right is effectual when the circumstances are such that the claimant is estopped from asserting the homestead right." *Id.* But, a debtor "may not preclude himself from claiming the homestead exemption solely by the act of disclaiming property as his homestead." *Id.*

45. The Fifth Circuit interprets Texas law to provide for two situations where a debtor is estopped to claim a homestead exemption in light of declarations made to a mortgagee to the contrary:

1) the debtor owned two or more noncontiguous pieces of property, any of which—but not more than one—could constitute a homestead; or 2) the property described in the disclaimer was not being used for homestead purposes.

In re McDaniel, 70 F.3d 841, 843 (5th Cir. 1995); see *In re Bradley*, 960 F.2d 502, 510 n.16 (5th Cir. 1992) (citing *Bland*, *supra*).

46. The Court construes the facts of this case to fall outside either of the two situations outlined in *McDaniel*. The first situation does not apply because *both* 2705 Guadalupe *and* a portion of the Ranch constitute the Baums' rural homestead. The second situation does not apply as the Baums were using the Ranch for homestead purposes.

47. The Fifth Circuit in *McDaniel* and *Bradley* looked to the *Bland* case out of the Fort Worth Court of Appeals as the Texas authority on the issue. The court in *Bland* states as follows:

Essentially, there are three different situations involving a homestead claimant's interest in land wherein the claimant might be estopped to claim the homestead exemption in light of declarations made to a mortgagee prior to, or contemporaneously with, the signing of a mortgage contract: (1) the claimant owns only one piece of property, and said property is being used as the claimant's homestead at the time of the mortgage; (2) the claimant owns more than one piece of property at the time of the

mortgage, but only one parcel could be the homestead as a matter of law; and (3) the claimant owns more than one piece of property which has been used and occupied as a homestead prior to the time one of them is mortgaged.

48. As noted by the court in *Bland*, the first situation is the simplest. *Bland* said the courts are unanimous in holding that the claimant is not estopped by a declaration of non-homestead. *Id.* at 383. “This holding is based on the theory that the fact of actual possession and use of the property as a home is of so obvious a nature at the time of the mortgage that the lender cannot close his eyes to the facts.” *Id.*

49. *Bland* elaborates on the second situation, describing it as “where the claimant owns more than one piece of land, but only one of the lots, as a matter of law, could constitute the homestead at the time of the mortgage contract.” *Id.* A claimant is not estopped here as well. The rationale for denying estoppel is the same as in the first situation: “The lender cannot shut his eyes to the fact that the mortgaged premises, which was being occupied at the time the deed of trust was executed, was the only property suitable for homestead purposes.” *Id.* at 284 (citations omitted).

50. The third situation, according to *Bland*, creates the greatest possibility of applying estoppel principles. *Bland* characterized the situation as one in which “the claimant owns two or more pieces of property which may constitute the claimant’s homestead at the time the claimant mortgages one of the parcels for some reason other than for purchase money or improvements thereon.” The court then stated, “where the tangible facts respecting two pieces of property are such that the homestead character could attach to either, to the exclusion of the other, according to the intention of the claimant, a declaration by the claimant of his intention in this respect may estop the claimant from disputing the truth of the declaration.” *Id.* at 284.

51. In the instant case, the Baums' homestead as of July 30, 2002, consisted of 2705 Guadalupe and a portion of the Ranch. The facts, therefore, fall outside either of the two situations outlined by the Fifth Circuit in which a disclaimer will bar the debtor from claiming homestead rights. The facts of this case do lend some ambiguity to the analysis, however. For example, the mere fact that the Ranch itself well exceeds 200 acres complicates the case. The Ranch, being eleven miles away from 2705 Guadalupe, is certainly not proximate to the actual residence where Mrs. Baum and the children lived. Additionally, the Baums asserted, for the first time at trial, that 2705 Guadalupe was a rural homestead. This evidence came in without objection. FED. R. CIV. P. 15(b); *Apple Barrel Productions, Inc. v. Beard*, 730 F.2d 384, 389 (5th Cir. 1984) ("Even if not raised by the pleadings, once issues are presented and argued without objection by opposing counsel, such issues are tried by the implied consent of the parties and are treated as if they had been raised in the pleadings."); *Yaquinto v. Greer*, 81 B.R. 870, 876 (N.D. Tex 1988) (citing *Apple Barrel*, *supra*).

52. Despite the complexities of this case, the facts and circumstances justify a conclusion that the Baums are not estopped to claim a portion of the Ranch was homestead as of July 30, 2002. The Baums purchased the Ranch in July 1999 with the intention of eventually building a home on the property. The home at 2705 Guadalupe was termed a "temporary residence" and was used as a home during the construction of their residence at the Ranch. The evidence is clear that, during their time at 2705 Guadalupe, the Baums treated each home as their homestead. They filed an application for residential homestead exemption with the Coleman County Appraisal District for 2705 Guadalupe on February 4, 2002. Def.'s Ex. 17. At the same time, however, the Baums were also using the Ranch for various homestead purposes. The Bank was fully aware that the Baums

were building a home at the Ranch. Indeed, the Bank financed the construction of the home. The closing of the Loan with the Bank and the Baums' sale of 2705 Guadalupe occurred almost simultaneously. In fact, the closing of 2705 Guadalupe was originally scheduled to occur in early August 2002. The Bank had to know that the effect of the homestead disclaimer was to deny the Baums any homestead rights whatsoever. Estoppel is appropriate where the facts are ambiguous, and the lender thereby relies on the homestead affidavit and disclaimer to confirm the borrower's homestead. TEX. CONST. art. XVI, § 50(d). This is not the case here as the Bank knew well prior to closing of the Loan that the Baums were building a home at the Ranch and intended to make it their permanent residence.

53. The Court is satisfied that the homestead disclaimer does not estop the Baums from asserting homestead rights to the Ranch.

Effect of Foreclosure

54. Although 2705 Guadalupe and a portion of the Ranch constituted the Baums' homestead as of July 30, 2002, the Bank holds substantial valid debt against the Ranch. From the \$750,000 loan, the Bank financed the payment of the purchase money lien in the amount of \$172,141.68. In addition, the evidence reflects that the Bank's deed of trust secured a valid contractual mechanic's lien in the approximate amount of \$259,000.

55. To the extent the Bank's deed of trust secured these amounts, the foreclosure was valid. The Baums' sole objection to the Bank's lien and, ultimately, the foreclosure sale is that both were invalid because the Ranch was their homestead. Other than the fact that the foreclosure occurred, no other evidence was submitted regarding the foreclosure sale. There is no evidence

showing any irregularity in the sale. *Chapa v. Herbster*, 653 S.W.2d 594, 601 (Tex. App.--Tyler 1983) (burden of proof to show that foreclosure sale under deed of trust was invalid rests with borrower). Nor was there any evidence submitted that specifically identifies the portion of the Ranch that is homestead. Indeed, as noted, the issue of *both* 2705 Guadalupe and the Ranch constituting the Baums' rural homestead did not arise until trial. To the extent a deed of trust secures valid debt against a homestead, the lien created by the deed of trust is enforceable. *Gregory v. Sunbelt Sav., F.S.B.*, 835 S.W.2d 155 (Tex. App.-- Dallas 1992, writ denied). Foreclosure under such valid lien is likewise proper, even if other debt secured by the deed of trust lien is not properly secured by homestead. *Id.* at 160. The Court can only conclude, therefore, that the January 6, 2004, foreclosure sale of the Ranch was valid and cannot be set aside.

Federal Truth in Lending Act

56. It is the Court's understanding that the Baums abandoned their claim regarding the Federal Truth in Lending Act (the "Act"). At trial, counsel for the Baums conceded that the Bank held a valid lien for purchase money and funds advanced for construction of the residence at the Ranch. It is the plaintiffs' burden to bring this case within the scope of the Act. *See Katz v. Carte Blanche Corp.*, 496 F.2d 747 (3rd Cir. 1974).

57. As the Baums used approximately \$259,000 to complete construction of their residence at the Ranch and \$172,141.66 to payoff the purchase money lien held by the Allens, the Loan may indeed be a consumer loan under the Act. *Bokros v. Associates Finance, Inc.*, 607 F. Supp. 869, 871-72 (D.C. Ill. 1984) (where the debtor received loan proceeds for varying purposes, the court must "refer to the use of more than half the funds" as the measuring point from

which to judge the overall purpose of the loan).

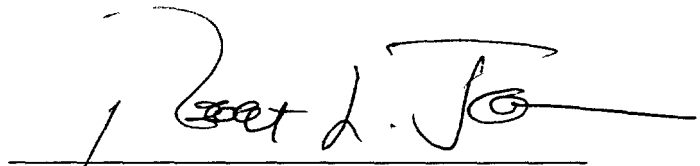
58. The parties stipulated that the Baums, by letter dated November 23, 2003, requested rescission of the Loan. There is no evidence that rescission applies, however. Assuming they had a right to rescind the transaction, the Act would require them to “tender the money or property to the creditor or, where the latter would be impracticable or inequitable, tender its reasonable value.” 15 U.S.C. 1635(b). Again, there is no indication or evidence that the Baums intended, or even had the ability, to return the proceeds of the Loan. As Baum bears the burden of proof, the Court must find that the Baums have not met their burden on this issue.

59. If appropriate, these conclusions of law shall be considered findings of fact.

Conclusion

The Court concludes that the Baums, as of August 30, 2002, had a rural homestead consisting of a 2.292 acre tract at 2705 Guadalupe and a portion (an undesignated 197.708 acres) of the 392.75 acre Ranch. The Baums are not estopped from making such homestead claim. Despite this, the Bank’s foreclosure of the Ranch property was performed pursuant to a deed of trust that secured valid debt against the Ranch. The relief requested by the Baums is denied and any pending lis pendens is cancelled. All other relief by either party is denied.

SIGNED December 29, 2004.

A handwritten signature in black ink, appearing to read "Robert L. Jones", is written over a horizontal line.

ROBERT L. JONES

UNITED STATES BANKRUPTCY JUDGE